



State of Utah  
Department of Commerce  
Division of Public Utilities

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## MEMORANDUM

**To:** Public Service Commission

**From:** Chris Parker, Director  
Artie Powell, Energy Section Manager  
Carolyn Roll, Technical Consultant  
Joni Zenger, Technical Consultant

**Date:** March 30, 2017

**Re:** Docket No.17-035-17, Division's Audit of PacifiCorp's 2016 Fuel Inventory Policies and Practices.

### RECOMMENDATION

The Division has reviewed PacifiCorp's (the Company) 2016 fuel inventory policies and procedures and finds that the Company is in compliance with the Public Service Commission's (Commission) directive in Docket No. 09-035-23. No further action is required.

### ISSUE

This memorandum is in response to the Commission's Report and Order in Docket No. 09-035-23 that directs the Division to conduct an annual audit of the Company's fuel inventory management policies, procedures, and actual practices and provide a summary of its audit and associated findings to the Commission by no later than March 31 of each year for the previous year's activity.<sup>1</sup> This memorandum reports on the Division's seventh annual audit and report to

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<sup>1</sup> Docket No. 09-035-23, Report and Order on Revenue Requirement, Cost of Service and Spread of Rates, February 18, 2010, p. 106.

the Commission. This report does not preclude the Division's analysis of coal inventory levels or any associated net power costs issues in the current Energy Balancing Account filing (Docket No. 17-035-01) or in upcoming general rate case proceedings.

## **DISCUSSION**

In conducting its review, the Division met with the Company's Fuel Resources Department on March 14, 2017. At the meeting the Division discussed the assumptions and inventories at each of the Company's owned and affiliate plants. The Division also looked at plant deliveries, coal supply, and coal consumption at PacifiCorp's operating plants. The Division reviewed confidential documents, including the December 2016 coal inventory levels and PacifiCorp's Coal Inventory Policies and Procedures (Manual) dated January 1, 2016. The Division looked at both historic and average stockpile levels, compared these to the Company's targeted inventory levels, and determined if the Company met its targeted levels. The Division verified that the Company has in place tracking and monitoring requirements associated with its policies and procedures. The Fuel Resources Department monitors inventory levels and aerial surveys are performed quarterly for PacifiCorp operated coal plants.

A third-party review of the Company's coal procurement policies and management practices was first performed in 1991 and again in 1995 by Energy Ventures Analysis, Inc. (EVA), who were retained by an Inter-Jurisdictional Task Force to review PacifiCorp's fuel management and coal supply practices.<sup>2</sup> As part of the EVA recommendations, PacifiCorp established stockpile targets for each of its coal generating plants. A subsequent review took place in the 2009 to 2010 timeframe when the Company retained Pincock Allen & Holt (PAH) to analyze the coal inventory policies associated with its plants in Utah and Wyoming. The PAH assignment resulted in two separate reports. The first report (Phase I of the assignment) dated August 13, 2009, addressed the Carbon, Huntington, and Hunter plants in Utah.<sup>3</sup> The second report (Phase

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<sup>2</sup> Confidential Evaluation of the Coal Procurement Policies and Coal Management Practices of PacifiCorp, prepared by Energy Ventures Analysis, Inc., January 1991; Confidential Update to Evaluation of the Coal Procurement Policies and Coal Management Practices of PacifiCorp, prepared by Energy Ventures Analysis, Inc., July 1995.

<sup>3</sup> Coal Inventory Policies for Coal-Fired Power Plants in Utah, PAH, dated August 13, 2009.

II) dated January 28, 2010, covered the Wyodak, Dave Johnston, Jim Bridger, and Naughton plants in Wyoming.<sup>4</sup>

Per the Division's recommendation in its March 31, 2014 audit report,<sup>5</sup> the Company performed an updated analysis of its current coal inventory policies and updated the stockpile target levels at its Utah and Wyoming coal operating plants. The Company retained the consulting firm Runge, Pincock, Minarco (RPM), (PAH's successor) to conduct the analysis and report. The RPM report was completed on September 15, 2015 and was received by the Division on March 14, 2016. The Company updated its 2016 Coal Inventory Policies and Procedures based on the RPM Coal Inventory Study. The Division reviewed both confidential consultant reports.

The Company has interests in the Cholla plant in Arizona and the Craig and Hayden plants in Colorado. Since the inventory levels for these plants are determined collectively by the plant owners and PacifiCorp is a minority owner in these plants, an analysis of these plants by RPM was not performed.

## **FINDINGS**

The Division has reviewed the Company's Coal Inventory Policies and Procedures and has conducted its own analysis of target levels versus actual inventory of coal at the Company's generation plants. The Company's commitment to the goal of providing low-cost power to its customers drives its fuel procurement practices. The Company's Manual states that the Company strives to optimize delivered fuel costs and ensure supply reliability, while providing appropriate fuel supplies and qualities based on the particular needs at each generating plant.

The objectives of the Company's fuel management practices as presented in the Manual are to provide the lowest cost fuels over the long run, maintain adequate inventory levels at each thermal generation station, and build a portfolio of fuels. Consideration is given to the delivered

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<sup>4</sup> Coal Inventory Policies for Coal-Fired Power Plants in Wyoming, PAH, dated January 28, 2010.

<sup>5</sup> Docket No. 14-035-35, Division's Audit of PacifiCorp's 2013 Fuel Inventory Policies and Practices, March 31, 2014.

cost of fuel, reliability of supply, fuel quality, environmental impacts, financial or risk exposure, impact on operations and/or operational costs, transportation, and flexibility.<sup>6</sup>

The Division identified issues that currently affect the Company's inventory and procurement practices. These include: a decline in coal-fired generation, geologically complex mines, the dynamics of the coal industry, and environmental laws and regulations. Each of the coal basins is managed as a system, although each coal basin is unique. The Company employs a diversified coal supply strategy due to a decrease in coal suppliers, the need to blend lower-quality coal with higher-quality coal in order to get optimized fuel burn, plant outages, higher rail rates, and third-party coal contract revisions, re-openers, or escalation clauses.

The Division determined that the Company is factoring in its longer-term analyses and planning for emerging environmental regulations, long-term basin depletion, coal quality, the financial stability of coal companies in Utah, and the fact that the market is not liquid. The Division notes that the coal industry in general has experienced an unprecedented year with plant shutdowns, increased industry concentration, layoffs, bankruptcies, and changing market dynamics. A large part the industry continues to be affected by strict environmental policies, and over the past few years the industry has seen power plants that are closing or have switched from coal- to natural-gas-fired generation. Low natural gas prices and the impact of renewable generating resources, such as wind and solar, have also contributed to the dramatic decrease in demand for coal. The Division notes that the Company's fuel procurement policies and practices provide some flexibility in order for the Company to react to these types of changing market conditions, even during the tumultuous past year.

The Division's audit identified the following key findings:

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<sup>6</sup> PacifiCorp's Confidential Coal Inventory Policies and Procedures, January 1, 2016 (Here and elsewhere in the Division's Audit report, the Division paraphrases the Company's Manual to protect confidential information.)

The Company has formal Coal Inventory Policies and Procedures in place that it adheres to. According to the Company's policies, the Company's goal and commitment to provide low-cost power to its customers drives its fuel procurement practices.

1. Inventory levels at PacifiCorp's Utah plants are above target levels at year end. The Division discussed this with the Company and determined that, given the economic risk and tradeoffs at Utah plants, the short-term high level is justified. This is an example where the flexibility of the Company's fuel management practices proves beneficial. Other factors that continue to affect inventories at Utah plants are difficult mining conditions and steady reserve depletion. In addition, demand continues to stagnate, and coal production forecasts predicted a three percent drop in production in 2016.<sup>7</sup> The Company expects that it will take a few years to get back to its longer-term target levels as it manages its take-or-pay contract commitments. The Company's procurement strategy protects the Company's shareholders and ratepayers from the risk of paying liquidated damages that might have otherwise been incurred.
2. With regard to the Company's Southwest Wyoming plants, mine production issues were a key factor affecting the Wyoming plants in 2016. The Company established new inventory targets in 2015, and is continuing the process of gradually building inventory to meet newly established levels. Naughton generating Unit #3 is planned to be retired at the end of either 2017 or 2018.<sup>8</sup> The Company is in the process of transitioning to its long-term inventory target, since the closure of Naughton Unit #3 is between one to two years away. The Company plans to maintain its inventory levels at its transitional targets until the unit closure. In Wyoming, the Jim Bridger inventory levels were below targeted levels at year end 2016, and the Company expects to replenish its inventory to the target level by year-end 2017.

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<sup>7</sup> Utah's Extractive Resource Industries 2015, Circular 120 Utah Geological Survey, 2016, p. 20.

<sup>8</sup> PacifiCorp's IRP public meeting #8, March 2-3, 2017, Regional Haze Sensitivity case RH-5a, p. 21. (Note: The Company has not made any individual unit commitments at this time. These outcomes will ultimately be decided by litigation and future negotiations.) In the Division's 2015 report, Naughton was expected to close at year end 2017, based on PacifiCorp's IRP Update, March 31, 2016.

3. Power River Basin plants continue to experience service interruptions associated with rail transportation out of the Powder River Basin. There was a serious railroad track accident at the end of 2016, resulting in inventory levels being slightly below target at Dave Johnston at year end. Inventory levels fluctuated throughout the year, and inventories are still below the inventory targets recommended in the RPM consultant report. The Company will continue to increase inventory to reach its targeted levels by the end of 2017, in compliance with its Coal Inventory Policies and Procedures.
4. Inventory levels at the Company's joint-owned plants were well above target levels due to unplanned outages and a decrease in coal consumption. As a minority owner PacifiCorp has limited influence over the inventory levels at those plants because inventory levels are determined collectively by the plant owners. The plant owners expect the inventory levels will be within targeted levels by the end of 2017.

With respect to the Division's overall audit, the Division recognizes that the coal industry is facing unprecedented challenges that require some of the Company's coal plants to be either above or below targeted inventory levels in the short term. Where target levels are outside of the targeted levels, the Company has plans in place to bring the inventory stock into targeted levels as soon as practicable.

The Company updated its Coal Inventory Policies and Procedures in 2016 based on the analysis in the September 15, 2015 RPM report.<sup>9</sup> The Division has reviewed the Policies and Procedures, dated January 1, 2016, which is the most current Manual. The Division finds that the Company is in compliance with the Commission's directive in its 2009 Report and Order with respect to its fuel inventory policies and procurement practices.

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<sup>9</sup> Docket No. 16-035-11, Confidential Coal Inventory Study for Coal-Fired Power Plants in Wyoming and Utah, Runge, Pincock, Minarco, September 15, 2015 (filed with the Commission on March 14, 2016).

The Division re-iterates that in the Commission's August 10, 2012 letter<sup>10</sup> confirming to the Company that it had complied with its Fuel Inventory Policies and Practices, the Commission determined that the Company should provide to the Division a copy of any revisions or updates to the Manual within 60 days after the revisions. Again, the Division requests that all future updates to the Manual be provided to the Division along with a redline copy of the updates to the Manual within the 60 days, as stated in the Commission's letter.

## **CONCLUSION**

The Division concludes that: (1) the Company has formal policies and procedures in place for its fuel procurement and coal inventory levels; (2) the Company has generally adhered to its policies and procedures in 2016, and as amended with an effective date of January 1, 2016; and (3) the Company's policies provide flexibility for the Company to react to the unprecedented changes in the market that the industry faced this past year. The Company's Manual states that the Company strives to optimize delivered fuel costs and ensure supply reliability, while providing appropriate fuel supplies and qualities based on the particular needs at each generating plant. The objectives of the Company's fuel management practices as presented in the Manual are to provide the lowest cost of fuels over the long run, maintain adequate inventory levels at each thermal generation station, and build a portfolio of fuels. The Division requests that the Company provide to the Division all future updates to the Manual, along with a redline copy of the changes that were made to the Manual within 60 days.

The Division has reviewed the Company's Coal Inventory Policies and Procedures and has conducted its own analysis of target levels versus actual inventory of coal at the Company's generation plants. The Division notes that the Company is generally in compliance with its policies and procedures or has plans to do so in the near future.

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<sup>10</sup> Docket No. 09-035-23, Correspondence from Gary L. Widerburg, August 10, 2012.

CC Bob Lively, Rocky Mountain Power  
Michele Beck, Office of Consumer Services